

# Severance Tax Bonding Program: Overview and Recent Changes



**PRESENTATION TO THE  
LEGISLATIVE FINANCE COMMITTEE  
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# Outline

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- Overview of Severance Tax Bonding (STB) program
- Cheat Sheet: Four types of STBs
- HB236 summary and fiscal impacts (Laws 2015)
- History and forecast of Severance Tax Bonding Fund (STBF) Revenues
- STB capacity calculation example: FY16
- Common questions on STBs
- History and forecast of Severance Tax Permanent Fund (STPF) contributions
- History and forecast of STPF distributions to the General Fund
- Use of STB by project type

# Overview of Severance Tax Bonding Program (1 of 2)

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- The modern Severance Tax Bond program dates to 1973 along with the creation of the STPF.
- Severance taxes are paid by mineral extraction industries on the value of resources severed from the ground.
- Taxes are remitted to the Taxation and Revenue Department, then deposited into the STBF.
- Funds in the STBF are only available for paying debt service (principal and interest), limited costs of administering the STB program, or for semi-annual transfer to the STPF.
- For decades, roughly 50% of STBF revenue was used for bonding and 50% went to the STPF. Gradually bonding increased to 95%.

# Overview of Severance Tax Bonding Program (2 of 2)

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- Beginning in 1999, after the Zuni lawsuit, the Supplemental STB program was created to pay for public school facility improvements.
- Since FY2000, over \$2.7 million has been issued for public school facilities and the facilities condition index of public schools has improved dramatically.
- HB236: In FY16, Senior STBs may be issued up to the point where debt service can be paid with 49.4% of the *lesser of* prior or current fiscal year STBF revenue. *This coverage test is phasing down to 47.6% for FY19 and beyond.*
- HB236: In FY16, Senior and Supplemental STBs may be issued up to the point where debt service can be paid with 94.4% of the lesser of prior or current fiscal year STBF revenue. *This coverage test is phasing down to 86.2% for FY22 and beyond.*

# Cheat Sheet: Four Types of Severance Tax Bonds

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	Senior	Supplemental
Short Term "Sponge" Notes	<p>Various Capital Projects (Legislative, Tribal, Colonias, Water)</p> <p>Taxable (Allows projects with Private Use and Non-Capital Purposes)</p> <p>Sold to State Treasurer each June and December</p> <p>1-2 Day Notes ("Pay As You Go")</p> <p>Projects Authorized by Legislature</p>	<p>Public School Capital Projects</p> <p>Taxable</p> <p>Sold to State Treasurer each June and December</p> <p>1-2 Day Notes ("Pay As You Go")</p> <p>Projects Certified by Public School Capital Outlay Council</p>
Long Term Bonds	<p>Various Capital Projects (Legislative)</p> <p>Tax-Exempt (Must exclude projects with Private Use and be for Capital Purposes)</p> <p>Sold Competitively (Typically each Spring)</p> <p>10-Year Bonds</p> <p>Projects Authorized by Legislature</p>	<p>Public School Capital Projects</p> <p>Tax-Exempt</p> <p>Sold Competitively (Issued Infrequently)</p> <p>10-Year Bonds</p> <p>Projects Certified by Public School Capital Outlay Council</p>

# HB236 Summary

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- First overarching changes to the STB capacity formula since 2004.
- May enhance the creditworthiness of STBs from a ratings perspective.
- Phased-in reduction in the amount of STBF revenue to be used for senior debt service from 50% to 47.6% from FY16-FY19.
- Reduction in senior capacity affects legislative capital outlay and water earmark, but holds tribal and colonias earmarks harmless.
- Reduces STBF revenue to be used for combined senior and supplemental debt service from 95% to 86.2% by FY22. Supplemental capacity is held harmless until FY19.
- Before, capacity was based on *previous* fiscal year STBF revenue. Now it is based on the *lesser of previous and current* fiscal year revenue. In years of STBF revenue decline, the STPF will still receive a sizeable contribution.

# HB236 Fiscal Impacts

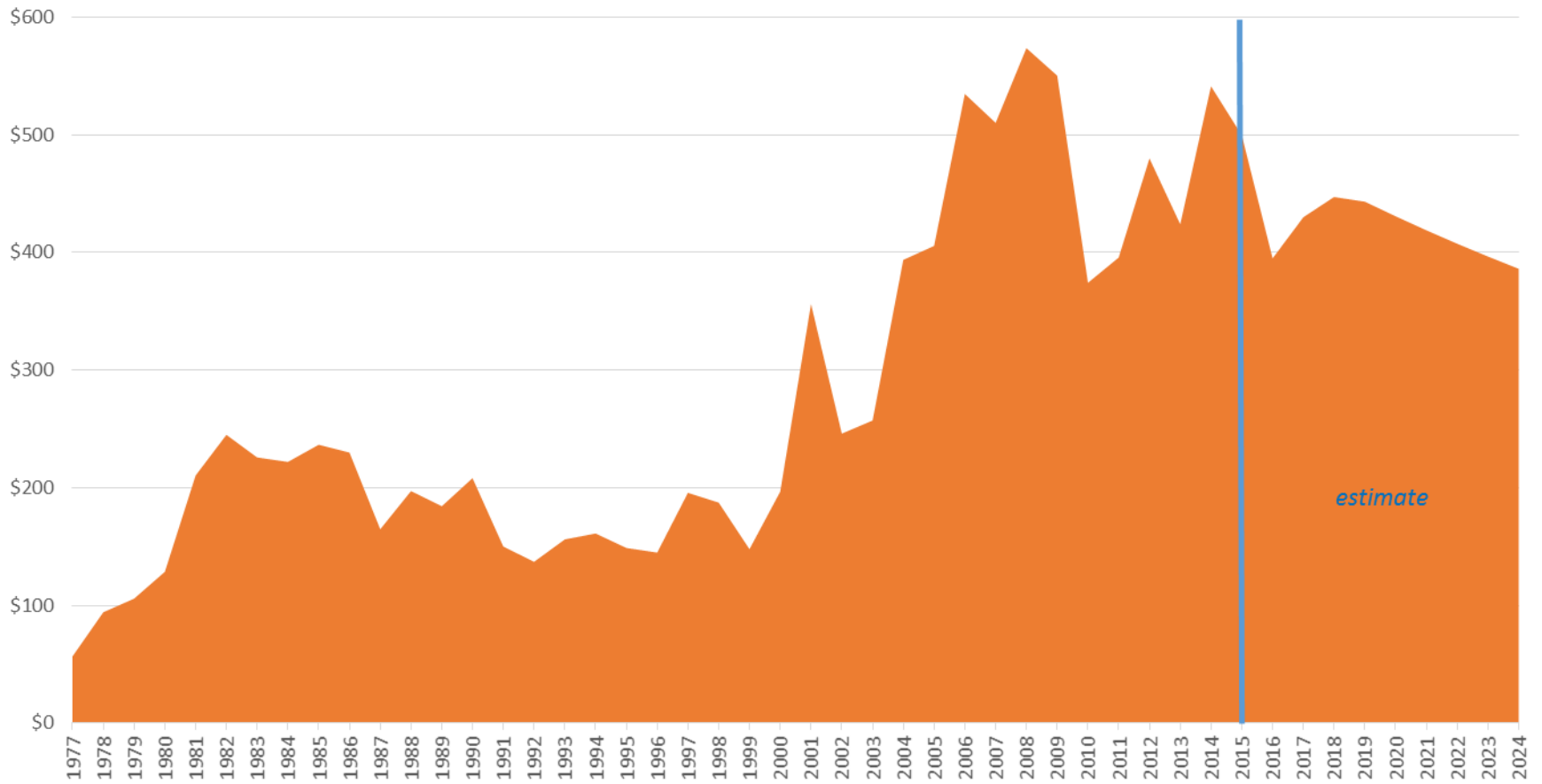
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- Overall, senior STB capacity is reduced by 11% or \$242 million over the next nine years.
- Supplemental sponge note capacity is held harmless until FY19, when the phase in begins. Capacity is reduced 5% in FY19, ramping up to 16% in FY24.
- Counterintuitively, supplemental sponge note capacity actually increased by \$31.4 million for FY16. Lowering the statutory coverage test for senior STB leaves more cash available in FY16 for supplemental sponge.
- Tribal & colonias earmarks increased from 5% of senior STB capacity to 6.5% in FY16 and 5.5% in FY17+ to hold them harmless.

**Detailed fiscal impacts of HB236 are found at the end of this presentation**

# Severance Tax Bonding Fund Revenue (\$ in millions)

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# Example of Calculating STB Capacity: FY16

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- FY15 Revenue \$499.5 million > FY16 Revenue \$394.9 million (*estimate*)

## **FY16 Senior STB Capacity**

- FY16 senior debt service payments may be up to 49.4% of \$394.9 million, or \$195.1 million.
- Existing debt service due on long-term senior bonds in FY16 is \$141.9 million.
- This leaves \$53.2 million for FY16 senior sponge notes (*note: taxable capacity for private use projects will be extremely scarce in FY16*).

## **FY16 Supplemental STB Capacity**

- FY16 combined senior and supplemental debt service payments may be up to 94.4% of \$394.9 million, or \$372.8 million.
- Assume entire 49.4% / \$195.1 million senior capacity is fully utilized.
- Existing debt service due on supplemental long-term bonds in FY16 is \$12.5 million.
- This leaves \$165.2 million for FY16 supplemental sponge notes.

# Common Questions on STBs (1 of 3)

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## **What does senior versus supplemental mean?**

- Senior STB have a senior or first priority lien in the event of default. As a result, Supplemental STBs are rated on notch lower than senior STBs.

## **What's the difference between a bond and a note?**

- Bonds are securities with a duration over one year; notes have a duration less than a year.
- New Mexico's severance tax notes are often called "sponge bonds"; they are usually 1-3 day duration notes that are sold to the State Treasurer to "sponge" up extra cash in the STBF before it would otherwise transfer to the STPF.

## **What are tax-exempt bonds?**

- The federal government subsidizes state and local public works by allowing interest earned on municipal bonds to be exempt from the bondholder's taxable income.
- Because of the tax exemption, the debt can be sold at a lower interest rate, which lowers the state's cost of borrowing.
- Use of tax-exempt bonds is limited to projects that are *capital assets* (i.e. brick and mortar), not used by a *private entity* (i.e. not leased to a non-profit), and other IRS restrictions.

# Common Questions on STBs (2 of 3)

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## **How are water, tribal and colonias earmarks set?**

The Severance Tax Bonding Act earmarks certain percentages of senior STB capacity each fiscal year. Earmarks are set through the Board of Finance's *January 15 certification of bonding capacity* to the Legislature:

- Water infrastructure (10%)
- Tribal infrastructure (6.5%, then 5.5%)
- Colonias infrastructure (6.5%, then 5.5%)

## **Does it matter if a project is authorized before it's ready to be issued? Yes!**

- Each year's capital bill fully utilizes capacity available, *less the amount of any projects authorized in a previous session but not yet issued/funded.*
- If a project is appropriated in FY15 2015 but not issued until FY16, it takes capacity away from the 2016 legislature. The Legislature in effect reserves capacity for the project every year until it is issued.
- The amount of projects carried over from one year to the next typically ranges from \$10-\$30 million.

## **How does the State Board of Finance (SBOF) bond issuance process work?**

- After each legislative session, the SBOF reviews all projects in the capital bill to see which are ready to meet all requirements of state and federal law.
- Long-term STBs are sold to the lowest bidding underwriter through competitive bid in open meeting.
- The SBOF deposits the bond proceeds in individual project accounts where they are invested by the State Treasurer until the project recipient requests reimbursement for valid expenditures.

# Common Questions on STBs (3 of 3)

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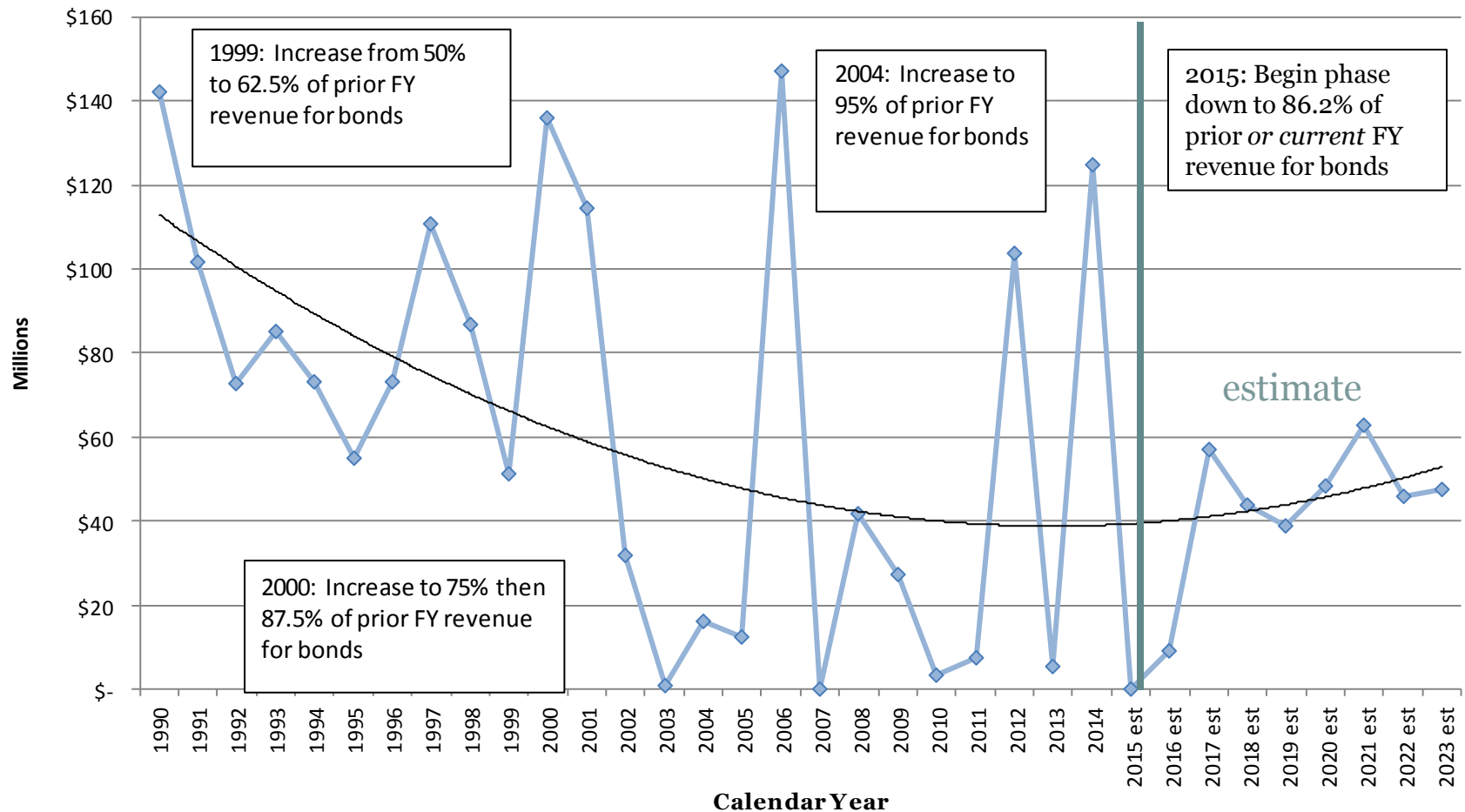
## **Why does it take so long for my project to receive funding?**

Projects may be delayed for one or more of the following common reasons:

- The project recipient cannot encumber 5% of the funds within 6 months of bond issuance or expend 85% of the funds within 3 years of bond issuance. Required by the capital bill and by IRS code (for tax-exempt long-term bonds).
- The project recipient does not fill out a questionnaire requesting the funds, often because they don't know for what purpose the funds are intended to be used.
- The funding is not sufficient to complete the project or a phase of the project.
- The project has Constitutional anti-donation issues. These commonly include:
  - The project will be operated by a private or non-profit entity but fair market rent or services in lieu of cash rent has not been established through a lease or operating agreement.
  - The public body receiving the appropriation does not own the site or the asset to be funded.
- The project recipient is not compliant with the State Audit Act and Executive Order 2013-006.
  - This list has shortened considerably since 2013. On average, about \$1-2 million of projects may be delayed at any given time due to noncompliance with EO 2013-006.

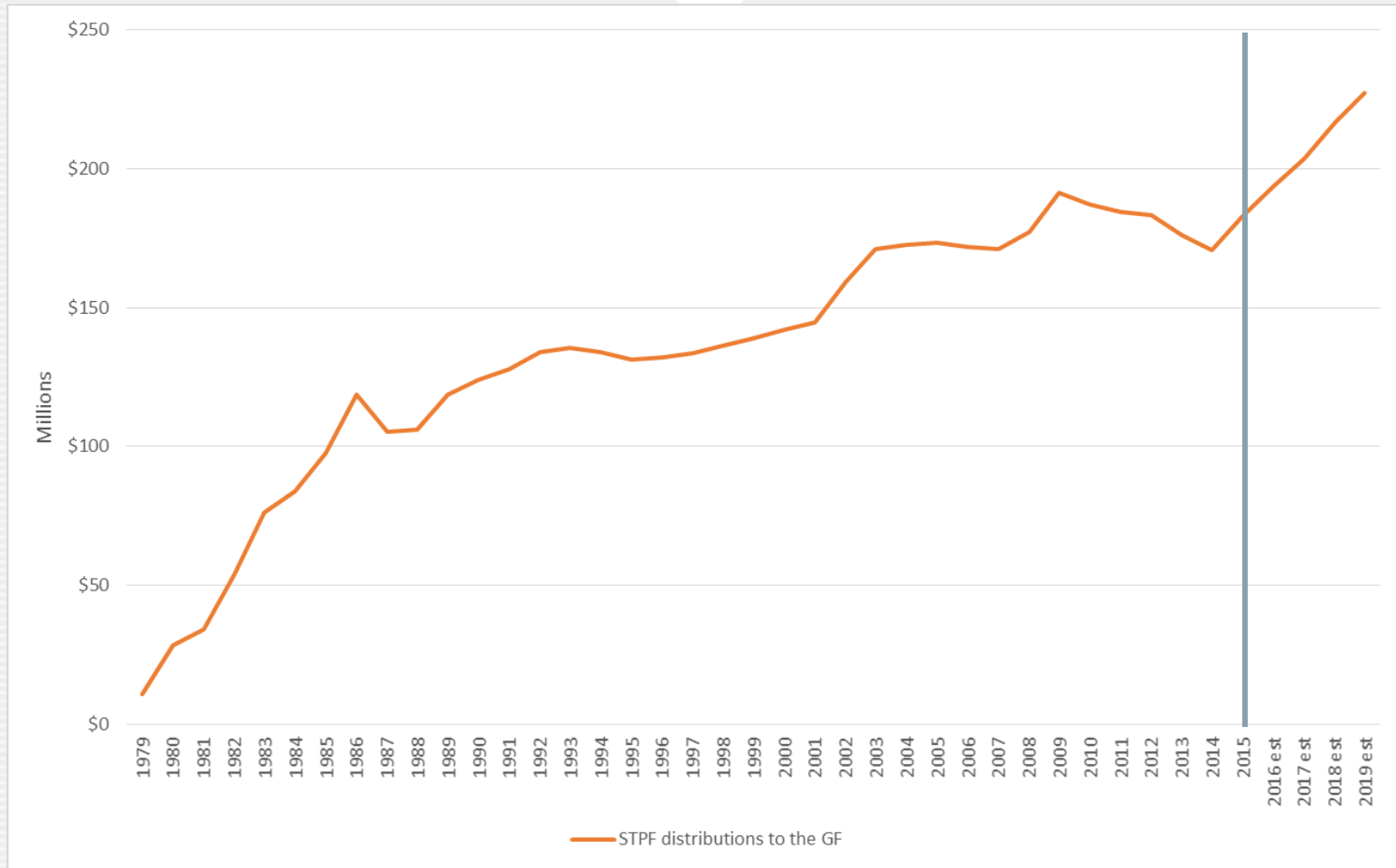
# Severance Tax Permanent Fund Contributions

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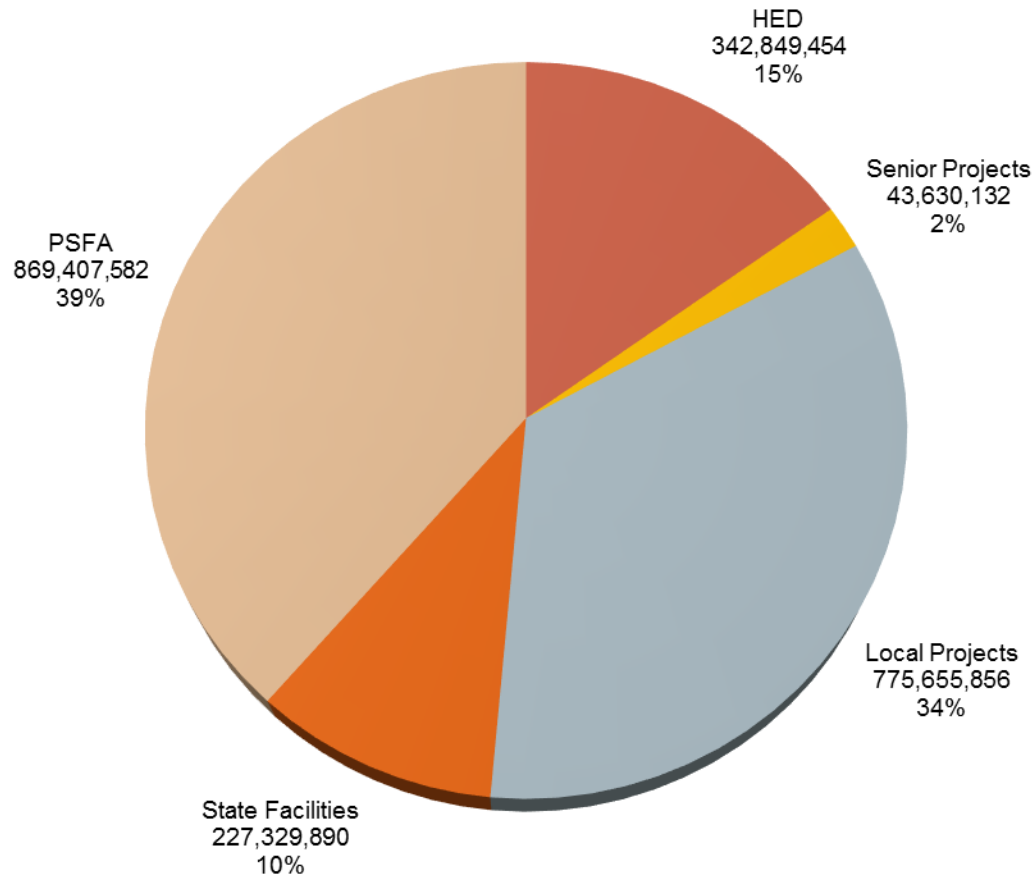
# Severance Tax Permanent Fund Distributions to the General Fund

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# Use of STB and GOB by Project Type (2011-2015)

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# Questions?

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# Fiscal Impacts of HB236 (1 of 3)

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## *Sources and Uses of Funds* *Bonding Capacity Available for Authorization* *February 2015 Estimate (\$ in millions)*

<b>Sources of Funds (millions)</b>	<b>FY16</b>	<b>FY17</b>	<b>FY18</b>	<b>FY19</b>	<b>FY20</b>	<b>FY21</b>	<b>FY22</b>	<b>FY23</b>	<b>FY24</b>	<b>9-Year</b>
Severance Tax Bonds	168.6	168.6	168.6	168.6	168.6	168.6	168.6	168.6	168.6	1,517.4
Severance Tax Notes	93.5	42.0	54.4	57.5	51.4	44.9	36.0	16.8	0.0	396.6
<b>Subtotal Senior STBs</b>	<b>262.1</b>	<b>210.6</b>	<b>223.0</b>	<b>226.1</b>	<b>220.0</b>	<b>213.5</b>	<b>204.6</b>	<b>185.4</b>	<b>168.6</b>	<b>1,914.0</b>
Supplemental Severance Tax Bonds	-	-	-	-	-	-	-	-	-	-
Supplemental Severance Tax Notes	133.9	165.5	181.5	189.4	187.8	182.3	186.0	183.3	178.4	1,588.2
<b>Subtotal Supplemental STBs</b>	<b>133.9</b>	<b>165.5</b>	<b>181.5</b>	<b>189.4</b>	<b>187.8</b>	<b>182.3</b>	<b>186.0</b>	<b>183.3</b>	<b>178.4</b>	<b>1,588.2</b>
<b>Total Sources of Funds</b>	<b>\$396.0</b>	<b>\$376.1</b>	<b>\$404.5</b>	<b>\$415.5</b>	<b>\$407.9</b>	<b>\$395.9</b>	<b>\$390.6</b>	<b>\$368.7</b>	<b>\$347.0</b>	<b>\$3,502.2</b>
<b>Uses of Funds (millions)</b>	<b>FY16</b>	<b>FY17</b>	<b>FY18</b>	<b>FY19</b>	<b>FY20</b>	<b>FY21</b>	<b>FY22</b>	<b>FY23</b>	<b>FY24</b>	<b>9-Year</b>
10% Water Projects	26.2	21.1	22.3	22.6	22.0	21.4	20.5	18.5	16.9	191.4
5% Colonias Projects	13.1	10.5	11.1	11.3	11.0	10.7	10.2	9.3	8.4	95.7
5% Tribal Projects	13.1	10.5	11.1	11.3	11.0	10.7	10.2	9.3	8.4	95.7
<b>New Senior STB Statewide Capital Projects</b>	<b>209.7</b>	<b>168.4</b>	<b>178.4</b>	<b>180.9</b>	<b>176.0</b>	<b>170.8</b>	<b>163.7</b>	<b>148.3</b>	<b>134.9</b>	<b>1,531.2</b>
Education Capital	133.9	165.5	181.5	189.4	187.8	182.3	186.0	183.3	178.4	1,588.2
<b>Total Uses of Funds</b>	<b>\$396.0</b>	<b>\$376.1</b>	<b>\$404.5</b>	<b>\$415.5</b>	<b>\$407.9</b>	<b>\$395.9</b>	<b>\$390.6</b>	<b>\$368.7</b>	<b>\$347.0</b>	<b>\$ 3,502.2</b>
Estimated STPF Transfer	-	50.3	34.1	15.3	10.6	19.5	-	-	10.8	140.6

# Fiscal Impacts of HB236 (2 of 3)

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*Sources and Uses of Funds*  
*Bonding Capacity Available for Authorization*  
*February 2015 Estimate adjusted for HB236 (\$ in millions)*

<b>Sources of Funds (millions)</b>	<b>FY16</b>	<b>FY17</b>	<b>FY18</b>	<b>FY19</b>	<b>FY20</b>	<b>FY21</b>	<b>FY22</b>	<b>FY23</b>	<b>FY24</b>	<b>9-Year</b>
Severance Tax Bonds	151.0	151.0	151.0	151.0	151.0	151.0	151.0	151.0	151.0	1,359.0
Severance Tax Notes	53.2	37.5	48.9	49.2	41.2	37.3	31.0	14.3	0.0	312.6
<b>Subtotal Senior STBs</b>	<b>204.2</b>	<b>188.5</b>	<b>199.9</b>	<b>200.2</b>	<b>192.2</b>	<b>188.3</b>	<b>182.0</b>	<b>165.3</b>	<b>151.0</b>	<b>1,671.6</b>
Supplemental Severance Tax Bonds	-	-	-	-	-	-	-	-	-	-
Supplemental Severance Tax Notes	165.2	165.5	181.5	180.5	168.4	156.9	157.3	153.1	149.0	1,477.4
<b>Subtotal Supplemental STBs</b>	<b>165.2</b>	<b>165.5</b>	<b>181.5</b>	<b>180.5</b>	<b>168.4</b>	<b>156.9</b>	<b>157.3</b>	<b>153.1</b>	<b>149.0</b>	<b>1,477.4</b>
<b>Total Sources of Funds</b>	<b>\$369.4</b>	<b>\$354.0</b>	<b>\$381.4</b>	<b>\$380.8</b>	<b>\$360.7</b>	<b>\$345.2</b>	<b>\$339.2</b>	<b>\$318.3</b>	<b>\$300.1</b>	<b>\$3,149.0</b>
<b>Uses of Funds (millions)</b>	<b>FY16</b>	<b>FY17</b>	<b>FY18</b>	<b>FY19</b>	<b>FY20</b>	<b>FY21</b>	<b>FY22</b>	<b>FY23</b>	<b>FY24</b>	<b>9-Year</b>
10% Water Projects	20.4	18.8	20.0	20.0	19.2	18.8	18.2	16.5	15.1	167.2
6.5% FY16/5.5% FY17+ Colonias Projects	13.3	10.4	11.0	11.0	10.6	10.4	10.0	9.1	8.3	94.0
6.5% FY16 /5.5% FY17+ Tribal Projects	13.3	10.4	11.0	11.0	10.6	10.4	10.0	9.1	8.3	94.0
<b>New Senior STB Statewide Capital Projects</b>	<b>157.2</b>	<b>148.9</b>	<b>157.9</b>	<b>158.2</b>	<b>151.9</b>	<b>148.8</b>	<b>143.8</b>	<b>130.5</b>	<b>119.3</b>	<b>1,316.5</b>
Education Capital	165.2	165.5	181.5	180.5	168.4	156.9	157.3	153.1	149.0	1,477.4
<b>Total Uses of Funds</b>	<b>\$369.4</b>	<b>\$354.0</b>	<b>\$381.4</b>	<b>\$380.8</b>	<b>\$360.7</b>	<b>\$345.2</b>	<b>\$339.2</b>	<b>\$318.3</b>	<b>\$300.1</b>	<b>\$ 3,149.0</b>
Estimated STPF Transfer	9.2	57.1	43.8	38.8	48.5	62.8	46.1	47.6	77.5	431.5

# Fiscal Impacts of HB236 (3 of 3)

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***Sources and Uses of Funds***  
***Bonding Capacity Available for Authorization***  
***Differences: Fiscal Impacts of HB 236 (\$ in millions)***

<b>Sources of Funds (millions)</b>	<b>FY16</b>	<b>FY17</b>	<b>FY18</b>	<b>FY19</b>	<b>FY20</b>	<b>FY21</b>	<b>FY22</b>	<b>FY23</b>	<b>FY24</b>	<b>9-Year</b>
Severance Tax Bonds	(17.6)	(17.6)	(17.6)	(17.6)	(17.6)	(17.6)	(17.6)	(17.6)	(17.6)	(158.4)
Severance Tax Notes	(40.4)	(4.5)	(5.5)	(8.3)	(10.2)	(7.6)	(5.0)	(2.5)	0.0	(83.9)
<b>Subtotal Senior STBs</b>	<b>(58.0)</b>	<b>(22.1)</b>	<b>(23.1)</b>	<b>(25.9)</b>	<b>(27.8)</b>	<b>(25.2)</b>	<b>(22.6)</b>	<b>(20.1)</b>	<b>(17.6)</b>	<b>(242.3)</b>
Supplemental Severance Tax Bonds	-	-	-	-	-	-	-	-	-	-
Supplemental Severance Tax Notes	31.4	-	-	(8.9)	(19.4)	(25.5)	(28.7)	(30.3)	(29.4)	(110.8)
<b>Subtotal Supplemental STBs</b>	<b>31.4</b>	<b>-</b>	<b>-</b>	<b>(8.9)</b>	<b>(19.4)</b>	<b>(25.5)</b>	<b>(28.7)</b>	<b>(30.3)</b>	<b>(29.4)</b>	<b>(110.8)</b>
<b>Total Sources of Funds</b>	<b>(\$26.6)</b>	<b>(\$22.1)</b>	<b>(\$23.1)</b>	<b>(\$34.8)</b>	<b>(\$47.2)</b>	<b>(\$50.7)</b>	<b>(\$51.4)</b>	<b>(\$50.4)</b>	<b>(\$47.0)</b>	<b>(\$353.1)</b>
<b>Uses of Funds (millions)</b>	<b>FY16</b>	<b>FY17</b>	<b>FY18</b>	<b>FY19</b>	<b>FY20</b>	<b>FY21</b>	<b>FY22</b>	<b>FY23</b>	<b>FY24</b>	<b>9-Year</b>
10% Water Projects	(5.8)	(2.2)	(2.3)	(2.6)	(2.8)	(2.5)	(2.3)	(2.0)	(1.8)	(24.2)
Colonias Projects	0.2	(0.2)	(0.2)	(0.3)	(0.4)	(0.3)	(0.2)	(0.2)	(0.1)	(1.7)
Tribal Projects	0.2	(0.2)	(0.2)	(0.3)	(0.4)	(0.3)	(0.2)	(0.2)	(0.1)	(1.7)
<b>New Senior STB Statewide Capital Projects</b>	<b>(52.5)</b>	<b>(19.6)</b>	<b>(20.4)</b>	<b>(22.7)</b>	<b>(24.2)</b>	<b>(22.0)</b>	<b>(19.9)</b>	<b>(17.7)</b>	<b>(15.6)</b>	<b>(214.7)</b>
Education Capital	31.4	-	-	(8.9)	(19.4)	(25.5)	(28.7)	(30.3)	(29.4)	(110.8)
<b>Total Uses of Funds</b>	<b>(\$26.6)</b>	<b>(\$22.1)</b>	<b>(\$23.1)</b>	<b>(\$34.8)</b>	<b>(\$47.2)</b>	<b>(\$50.7)</b>	<b>(\$51.4)</b>	<b>(\$50.4)</b>	<b>(\$47.0)</b>	<b>\$ (353.1)</b>
Estimated STPF Transfer	9.2	6.8	9.7	23.5	37.9	43.4	46.1	47.6	66.7	290.9